CREDIT MANAGEMENT IN THE BANKING INDUSTRY:

A CASE STUDY OF

NIGERIAN AGRICULTURAL AND COOPERATIVE BANK

AND

FIRST BANK OF NIGERIA PLC

BY

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Certification

This project entitled "Credit Management in the Banking Industry: A Case Study of Nigerian Agricultural and Cooperative Bank Limited (NACB) and First Bank of Nigeria Plc", has met the requirement governing the award of the degree of Master in Business Administration, Ahmadu Bello University, Zaria and is approved for its contribution to knowledge and literary presentation.

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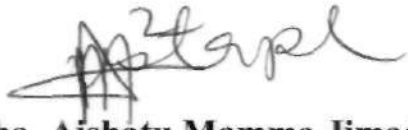
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Declaration

I hereby declare that this project is a product of my research analyses and findings and to the best of my knowledge, has not been published before. It has not been previously presented in any application for a higher degree. All works consulted have been duly acknowledged accordingly.



Mustapha, Aishatu Mamma Jimada.

Dedication

This project is dedicated to my beloved parents, Late Alhaji Sulaiman Ibrahim and Hajia Amina Laraba Sulaiman.

Acknowledgement

My sincere gratitude goes to the Almighty Allah (SWT) for his blessing towards the successful completion of this study and research work. I am greatly indebted to my supervisor, Mallam Nasiru Maiturare, for his acknowledgement of the study proposal, guidance and valuable contributions.

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Abstract

The dilemma facing the Nigerian banking industry as a result of high incidence of loan (credit) default by corporate and individual customers alike is multifarious and has now attained an alarming proportion. As a result of this, some banks have recently categorized more than 45% of their loan (credit) portfolio as non-performing or critical assets. This decision has been blamed on the various government policies, especially those of the 1980s and 1990s, typically called the Structural Adjustment Programme (SAP). This period was characterized by fall in oil revenue and the resultant balance of payments crisis.

Government needed to take steps to arrest the situation because of the danger it posed on the Nigerian economy in general and the financial sector, in particular. It resulted in corporate insolvency and therefore dealt a permanent damage to the economic survival of the country as a whole. This has necessitated our suggestion that there is need for an efficient and effective credit (loan) management for Nigeria's banking industry.

This is based on comparative analysis of credit management in the Nigerian Agricultural and Cooperative Bank Limited, a development bank and First Bank of Nigeria Plc, a commercial bank. In chapter one, the genealogy of credit management has been looked into in the two banks, while in chapter two, related literatures were reviewed in relation to the topic, i.e. credit management and management concepts. Chapter 3 and

four conducted an in-depth study of the credit management strategies of the two banks, and how the banks dealt with the problems that arose therefrom. Lastly, in chapter five, summary, recommendation and conclusion were drawn from the above analyses.

Our conclusion from our analysis is that for our banks to survive and be firmly rooted, emphasis must be placed on good management of credit portfolio.

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CHAPTER ONE

1.0 INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Banks occupy one of the most important positions in both the money and capital markets. They are therefore, very desirable for any economy. The need to manage all credit funds that accrue to them becomes very important. That is why all banks in formulating credit policy find it possible to accommodate and monitor the changing tides in the social, political and economic trends of the nation or country of operation.

The term, "credit" within the banking sector, refers to loans, advances, overdrafts, commercial papers, bankers' acceptance, and bill discounted, whose management encompasses all the activities involved in extending and repayment of credit facility. Credit operations therefore, include credit analysis, appraisal, disbursement of funds, complete record keeping and monitoring of such credit in order to ensure its payment on due date. Thus, efficient and effective credit management is very important.

Credit management is more pronounced when one looks at its impact on the economy. It is an undisputable fact that bank credit constitutes a major source of fund (money) supply. Lack of it may result in serious deflationary implications. More of it causes

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inflation if there is no increase in the level of production in the economy.

No wonder, the current inflation in the country is partly blamed on the huge government deficit arising from the massive credit lending made by banks to the public sector. However, there is no better way through which these banks can contribute to the growth and development of the economy other than by credit extension for productive investments, which can promote the welfare of the people. With good management of bank credit portfolio, the undesirable effect posed by excess funds, held outside the banks can be curtailed.

Credit management becomes imperative when customers fail to return what was extended to them, thereby complicating the credit portfolio and resulting in bad or doubtful debts. These may have arisen from poor evaluation and review of such facilities by credit managers as well as unsatisfactory follow up for readiness of project to commence after approval, poor and inadequate securities guarantee against default and draw down of facilities. Hence, credit management entails good understanding of risks associated with facilities and well-proven methods of recovering debts without loosing its good will.

1.2 HISTORICAL BACKGROUND OF THE BANKS

1.2.1 First Bank of Nigeria Plc

Founded and established in 1894 by Sir Alfred Jones, First Bank of Nigeria Plc was incorporated as a limited liability company on 31 March 1894, under the corporate name of Bank of British West Africa with a paid up capital of twelve thousand pounds sterling. Its name was changed to Standard Bank of Nigeria Limited in 1969 after being locally incorporated in response to the Companies and Allied Matters Decree of 1968. Ten years later, in 1979, the name was changed again to First Bank of Nigeria Limited. Under the privatization and commercialization act, the bank became a public liability company, and the name changed to First Bank of Nigeria Plc in 1991.

Presently, the bank operates with an authorized share capital of over N215.2 million, divided into six hundred million ordinary shares with total assets valued at over N33.95 billion and a deposit base of over N23.3 billion as indicated in the 1996/1997 annual report.

To add to its strength, the bank responded positively to competitions, so as to enhance its operation level, which culminated in decentralized decision making process, aggressive banking, fully computerized management information system and a highly well structured directorate system.

Large volume of loan portfolios and credit facilities within the various sectors of the economy and various products and services on offer, such as the Western Union Money Transfer, and First Cash, which offers cash withdrawals twenty four hours daily and instantly, are few of the products First Bank Plc offers to its numerous customers.

To top it all, the bank has diversified by floating Subsidiary Companies, which include FBN (Merchant Bankers), First Nominees Ltd, First Trustees Ltd and First Dependant Ltd. All these successes were achieved with the 90% Nigerian equity shares and 9.9% shares from Standard Chartered Bank Plc London, as foreign partner.

1.1.2 Nigerian Agricultural & Cooperative Bank Limited

Incorporated in 1972 and formally launched in March 1973, the Nigerian Agricultural and Cooperative Bank (NACB), was formerly known as Nigerian Agricultural Bank Ltd (NAB). In 1977, the Management of the bank was fully Nigerianized, resulting in the change of its name to NACB, to highlight the role of the bank in financing viable cooperative projects. The bank was established with the objectives of promoting agricultural production and rural development, and in addition to improve the incomes and the quality of life of Nigeria's rural population. In

carrying out these objectives, the bank finances mainly direct agricultural production, produce marketing and agro-allied projects.

The organizational structure and management of the bank was designed to oversee policy formulation and direction, which is the responsibility of a Board of Directors, usually appointed by the President-in-council. But the day-to-day running of the affairs of the bank is the responsibility of two committees: the Executive Committee and the Management Committee. Both committees are headed by the Managing Director and Chief Executive.

Chronologically, the banking operations are carried out at the Head Office, Zonal Offices and Branch Offices. In carrying out its activities, the bank is organized into Directorates. An Executive Director, who oversees the operations of the departments under him, heads each directorate. Each department is headed by a General Manager. Each department is also further divided into divisions and Units. The Executive Director (operations) is the only one among his equals assisted in the Head Office by Coordinators. The Bank's organizational charts at each level of operations are shown in appendices I, II and III.

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1.3 STATEMENT OF THE PROBLEM

The Nigerian banking industry has since 1988 been threatened by high incidence of bad debt. This translates to a debt burden for the banks. This is because the banks do not own the monies they lend out to borrowers. Such monies are owned by depositors and such deposits are often times of very short term or at best of medium term of not more than two years. The costs of bad debts to the banks are enormous. First, it reduces the value of the capital side of the balance sheet; it has rendered most banks technically insolvent and in some cases terminally distressed, and above all, has also eroded public confidence in the Nigerian banking system. These costs are applicable to the commercial as well as the development banks.

Existing literature has identified some of the factors responsible for incidence of bad debt in the Nigerian banking industry to include the following:

- Reckless credit policies, where facilities are not properly secured and securities documented or executed to ensure effective enforcement when default occurs.

- The securities do not cover lending adequately and as such makes it difficult to recover full amounts of money outstanding, when realized.
- Poor customers' attitudes towards debt repayment as such loans are regarded as part of national cake.
- Poor management team that does not monitor adequately its loan portfolios, which eventually degenerate to losses and makes recovery impossible.
- Lack of professional ethical standards, commitments and information necessary to support a sound credit base management; and lack of direction and utilization of facilities for the purpose they were advanced, rather than for projects they were not given.
- Undue influence of bank directors on the lending practices of the banks.

1.4 OBJECTIVE OF STUDY

The broad objective of this study is to assess the credit management systems or techniques in the commercial as well as the development banks in Nigeria. However, more specifically, this research work seeks to achieve the following objectives:

(i) To critically evaluate the conditions under which credit are granted to applicants in the First Bank of Nigeria Plc and the Nigerian Agricultural and Cooperative Bank Ltd;

(ii) To examine the techniques of credit monitoring and supervision from the stage of disbursement to the stage of debt recovery;

(iii) To find out whether the techniques of loan administration employed in the two institutions under study conform with the canons of lending.

1.5 SIGNIFICANCE OF STUDY

Following the Central Bank of Nigeria's prudential guidelines of November 1990, issued to all banks with the aim of sanitizing the industry in relation to credit administration, a lot of defaults has been witnessed in credit repayment due to lack of credit monitoring and supervision, and inadequate recovery policy and targets aimed at stimulating prompt payment of credit facilities. Lacks of sound credit policy to stimulate increase in lending, coupled with high level of correlation between credit and credit management and administration, and bad and doubtful debts, have been identified within all the banks.

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Finally, lack of prompt compliance with the credit guidelines policies put in place to alleviate or reduce the level of bad and doubtful loans in our banks and the attitude of our customers in relation to such credit, calls for concern. The significance of this study then is its concern at investigating the credit management techniques adopted in the Nigeria's banking sector which covers both the commercial and development banks, in an attempt to find solutions to the problem. It is worthy of note that with the new banking policy operating in Nigeria, there is little difference in operations between the commercial and merchant banks. This study is therefore significant because the result will provide a base for further work in the area.

1.6 SCOPE OF STUDY

The rate at which banks balance sheets are inundated with huge bad and doubtful debts is rather unhealthy for the corporate existence of banks in particular, and growth of the country's economy in general. Therefore, credit management has been critically evaluated in relation to the quality of credit appraisal lending and credit administration, in the selected institutions. Also, causes, cost and remedies for bad and doubtful debts and the

rationale and implication of the prudential guidelines in relation to banking operations, are among the factors examined.

1.7 LIMITATION OF STUDY

The issue of credit management has given the banks and government a great cause for concern. The reluctance of banks to disclose their level of bad and doubtful debts, and the means of recovery and management of such debts or credit, has constituted one of the major constraints of this study. Access to certain data has been through the published annual reports. One other limitation to this study has been lack of time and adequate resources to complete this work on time.

1.8 METHODOLOGY OF STUDY

Theoretically, the secondary data collected were from records of annual published reports of both banks and other relevant documents collected from these banks. Secondary data were also sought from journals, magazines and books related to credits and credit management.

1.9 DEFINATION OF TERMS AND CONCEPTS

Credit: Means the power to use a bank loan by giving a promise to pay both the principal and interest installmentally or in lump sum in the future. It is a present right to future payment and in the banking sector; lending and credit are often used interchangeably.

Credit Limit: Is the maximum amount the bank is prepared to invest in the customer by way of granting facilities.

Credit Period: It is the period of the credit life span. The length of period and its expiring date or time stipulated.

Collateral Securities: These are securities deposited by second or third party for the credit to secure the indebtedness of the customer with the advantage that in the event of bankruptcy or liquidation of the borrowers, repayment can be enforced.

Bad And Doubtful Debt: Is a loan or credit, which has become irrecoverable at the date of maturity. Facilities are termed bad or doubtful when the borrower fails to pay the loan or credit in accordance with the term and conditions of the loan (credit) agreement.

Default: This occurs when the borrower fails to repay both the principal and interest on the facility granted to him in accordance with the terms of agreement.

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Lending: Is the process where a customer is considered for and afforded the use of bank fund for specified business or personal purpose for a fixed period of time with a promise to repay the amount borrowed on an agreed future date with all interest.

Loan: Is the lending of money or funds by way of opening a loan account for an agreed sum of money and crediting that sum to the customer's account, whereby interest charged on the loan account are debited to the customer's account.

Overdraft: Involves granting an application request of a customer to overdraw his account i.e. to be in "Debt" or "Red" by withdrawing funds in excess of what is in the account or what he has, while interest is charged monthly on the amount actually overdrawn in excess.

Securities: Is anything tangible that gives the lender of any loan or credit some protection, guarantee and safety that the credit facilities given can be recovered in the event of default or nonpayment of facility granted at the expiration or maturity date.

CHAPTER TWO

2.0 LITERATURE REVIEW

There are several forms of bank lending or credit facilities in our present day banking services in Nigeria. These are loans, overdrafts, letters of credit, discounted trade bills, negotiable bills, investing in debenture stock, banker's acceptance and guild edged securities. All these are known as credit; their mismanagement gives rise to bad and doubtful debts.

However, emphasis here has been placed more on loans and overdrafts, which are so commonly known even to a layman and widely used with our banks. It should be noted that whatever form of lending is adopted, depends on the purpose and circumstances of the transaction of both the bank and the borrower. Thus, the bank becomes the "creditor" and the customer the "debtor."

2.1 REVIEW

2.1.1 Loans

In his book, Introduction To Banking, Foluso Olabisi states, "A loan was first initiated in the late 1950s and was intended to help customers procure their needs on lives purchase. Such a customer then pays the principal and interest on monthly installments. The monthly installment payment is a combination of

capital loaned plus interest added at the beginning. Such a loan differs slightly from the general live purchase contractual relation since the bank has no right on the object financed."

However, the management of such loans in our present day banking services is that it is being processed as a separate account of its own whereby the whole sum granted to the customer is released in lump sum, i.e. all is given after crediting of the customer's account, the drawing of all the sums and no charge is made. However, the subsequent entries now to the account will be repayment either installmentally or as a lump sum. Already, the charges of the bank are incorporated into the account and are reduced drastically with constant repayments.

Foluso Olabisi interpreted "overdrafts" as short-term loans with the interest charged being calculated on daily basis. With each withdrawal, the sum increases while it decreases with repayments (lodgments) made within the approved limit. An overdraft can be said to be like a running account and mostly approved to augment customer' working capital.

2.1.2 **Role of Credit Management in Banks**

J. M. Pendy in his book, "Financial Management" is of the view that the objectives of credit is not to maximize sales or to minimize the risk of "bad debts." He argues that if the aim were to

maximize sales, then the firm would have to sell on credit to its customers and on the other hand if the management decides to minimize bad debts risk, the firm may not sell at all to anybody on credit. The main objective of credit management is to maximize the value of the firm by achieving a trade off between liquidity and profitability. Thus, the firm should manage credit in such a way that sales are expanded to an extent to which risk remains within acceptable limits.

In relation to financial institutions, it can be said that, the objectives of credit management within banks should not be to maximize their credits and advances, or to minimize the risk of bad debts. The aim to maximize credit would then be that the banks have to keep on lending to all customers and on the other hand, if the management decides to minimize bad debts, the bank may not lend to anybody at all. This act will not only attract a penalty from the Central Bank of Nigeria (CBN), but can even paralyze the business of the bank.

Since the goal of credit management is to maximize the value of the company by achieving a trade off between liquidity and profitability, the company should manage its credit in such a way that credit are expanded to an extent to which risk remains

within acceptable limits. The goals of achieving maximum value for the banks with good management are:

(a) To obtain optimum credit;

(b) To control the cost of credit and keep it at minimum;

On the whole, an efficient and effective credit management can help to expand total revenue and can prove to be an effective tool for marketing. Efficient credit management helps to retain old customers and attract new customers to the banking industry.

2.1.3 **Criteria for Lending and Managing Credit**

After analysis of an application for credit facility, and investigations are made, a prospective customer is interviewed to ascertain what he wants to do with the facility, mode of repayment and purpose for use of the facility and length of time. His occupation, income, resources, experience and proven ability are also ascertained. However, even if the customer lacks certain experience or otherwise, the application will be processed for its merits and viability if it has all that the application forms request.

Summary of preceding pages and recommendations are essential and must be observed. However, in ascertaining good lending and efficient management of such credit, three basic principles of lending must be considered, which are:

(i) Safety consideration;

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(ii) Suitability of the lending proposition and;

(iii) Profitability.

Also, during investigation, the credit applicant information must be examined with an in-depth retrieval of useful data about the client. For these information are tools with which the company can be saved from losses of possible bad debts. Such information is retrieved from:

(i) Trade reference;

(ii) Bank reference;

(iii) Credit bureau report or register;

(iv) Published annual report account/information;

(v) Company ledger or client ledger.

The above details could save any financial institution or company from any possible loss, especially with bad debts.

2.1.4 **Financial Risk in the Banking Industry**

Banking is a risky transaction or business and risk enters into every facet of our activities because not all transactions are favourable or unfavourable as might be expected.

According to Aja Nwachukwu (1990) in his book "Risks and its Implication for the Nigerian Banking Industry" risks are a variance between one's expectations and realizations. This implies the existence of established probabilities for possible returns from

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future operations. The three known financial risks within our banks are:

(i) **Credit Risk or Default Risk**: This is concerned with the assets held by a bank as a creditor. A bank faces the danger that its debtors may not make payment on interest and principal as and when due/required. It therefore demands risk premium from its debtor and other things being equal, the greater the possibility that a debtor will default, the greater the default risk or the premium risk. However, this not withstanding, default may arise because of severe economic predicament, national hazards and political or government policies. Such risk occurred in the year 1990 and that prompted the CBN through its prudential guidelines to bring out the need for effective risk management and to energize the banks to be more conscious of the risk structure of its loan portfolios. Hence, the need to be more rigorous in evaluating applicants for loans and advances. Essentially, credit risk can be controlled or averted by the following means:

a. Maintaining adequate resources for possible loan losses;

b. Avoiding term credits with maturity of five years or more without substantial amortization;

c. Maintaining standards and control procedures for the approval of credit.

d. Accepting only readily marketable instruments as collateral for those credits supported by tangible securities.

e. Diversifying credit so as to avoid excessive concentration of credit risk among few individual debtors or within any geographical area;

f. Declining or refusing non-productive credits application, e.g. gambling.

(ii) **Liquidity Risk**: This is a situation where a bank's license can be withdrawn in relation to its liabilities as a debtor to its depositors. Such risk happened when creditors failed or are unwilling to renew or extend their credits to the bank. The risk under liquidity also affects reserve requirements. This happens when changes occurred and voluntary reserves are transformed into legally required reserve, thereby reducing the reserve needed for financial deposits as well as limit the ability of banks to extend credits. This

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type could endanger the solvency of the banking industry. However, liquidity risk is managed with the following categories:

- Assuring credit customers that funds are available to meet their borrowing requirements.
- Assuring deposit customers that funds are provided for withdrawal upon demand or at maturity.
- Maintaining the statutory liquidity ratio of 30%.
- Maintaining access to liquid resources sufficient to enable the bank to respond to potentially profitable credit or investments.
- Diversifying sources of funds in terms of types of instruments and that of maturity.

(iii) **Market Risk**: This reflects the influence of market forces upon the availability of funds, which creates liquidity risk, or upon movement in foreign exchange rates, which relate to economic terms. Financial and political development and market risk are inherent in virtually all sources and uses of funds. Market risk can be controlled by the following:

a. Operating activities of the money market;

b. Diversifying sources of funds, types of instrument and maturities.

2.1.5 **Loan Monitoring, Payment And Collection**

Most banks have systematic procedures for collecting loans payment. One process is to have a credit tellers and payment recorded and also regularly reviewed to identity past due loan and payments. Some banks have further modified their collection procedure, where cheques are written against a line or periodic payment cards are established. Hence, the borrowers authorize their banks to debit their account directly for an agreed minimum monthly installment on the outstanding balance on the loan. In addition, the borrower usually has the flexibility to pay more than this minimum pre-authorized repayment. In banks where the loan records are on computer, the dates when loans expire or payments are due from each borrower will be shown. This normally identifies borrowers who have not made their payment on time or on agreed date. The collection policy of banks is determined by the combination of collection procedures, such as letters, telephone calls, personal visits, use of guarantors and use of legal actions (both internal and external). One principal policy variable is the amount expended on collection procedure by the debt recovery

department. Within a range, the greater the related amount expended, the lower the proportion of bad debts and losses, and the shorter the average collection period. All things being equal, initial reductions will begin to have a significant effect by reducing the amount of bad debts and losses. However, additional expenditure tends to have little effect in further reducing these losses.

2.1.6 **Risk Assessment And Analysis**

Lending decision very much like investment are generally fraught with risks, but the ability of the banker to thoroughly assess and analyze such risks will often lead to qualitative decision (Osayameh 1986).

Risks associated with lending vary depending on its type. Although the cannons of lending do assist to a large extent with some idea of inherent risks on lending, an in-depth corporate diagnosis should be carried out so that the banker can act firmly on any proposal by analyzing a company's financial statement.

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CHAPTER THREE

3.0 CREDIT MANAGEMENT AND ADMINISTRATION IN NACB LIMITED:

Under credit management and administration, certain procedures are organized, because they have to be undertaken in order to achieve the objectives of efficient and effective credit management and administration. The principal motive behind the practice of lending is to nurture any credit request to life, be it for a project or personal problem. This is to ensure, in the case of a project, its growth and perpetual existence, such that it contributes meaningfully to the client's and corporate profitability and development as well as the development of the host community and the nation in general.

However, to ensure the security of its loans as well as the realization of their commitment to any loan (credit) and safeguard against any problem, a carefully designed sets of advisories (procedures) are laid to guide against credit calamities. These guides were not invented in a day, but have developed overtime in response to changes in the operational environment, which have made credit disbursement management and administration such a dynamic practice.

These procedures or guides for credit have been documented in operational manuals for large and small-scale loans, respectively.

3.1 NACB PROCEDURES FOR CREDIT FINANCING, ADMINISTERING AND MANAGEMENT:

By virtue of its responsibility, NACB has a very wide operational portfolio. It finances all forms of agricultural projects, ranging from arable crops, tree crops, horticulture, poultry and piggery to cattle rearing, rabbitry, fishery, forestry and timber production.

Others are agricultural produce marketing and processing. Credit administration for these enterprises types are carried out under the following credit/project portfolios or schemes:-

- The On-lending Credit Scheme
- Direct lending Credit Scheme
- Small holder direct loan scheme
- Workers scheme
- Marketing loans scheme
- Tractor hiring service scheme

In order to ensure efficient credit administration and management, all the schemes must pass through the four stages of project assessment. These are: -

(a) Project Identification

(b) Project Appraisal,

(c) Project Implementation, and

(d) Project Monitoring and Evaluation.

Each of the stages are hereunder discussed.

3.1.0 **Project Identification**

Project identification commences when an applicant approaches the bank for credit (financial) assistance to execute a project. The initial borrowing proposal must come from the applicant, and the bank is left with the task of deciding whether:

(a) The proposal is acceptable in the form presented,

(b) The proposal would be acceptable if it were amended,

(c) The proposal is not acceptable, or

(d) The identification reveals an existing project

(e) To pursue the applicant's request further or not.

As part of NACB guidelines, project identification is conducted first by, Desk Appraisal and second by an identification visits exercise. During project identification exercise, attention and emphasis are placed on the following aspects of the proposal:

(1) **Purpose Of The Loan**: After obtaining and filing the form (application form), the applicant must specify the purpose for which he is seeking the credit (financial) assistance. The purpose must conform to the lending objectives of the bank and particularly it must be legal. Hence, the legality of the project for which finance is being sought is primordial. However, a proposal may be legal but financing may be denied, if it does not meet the lending objectives of the bank. For instance, requesting NACB to finance a housing project is not in line with its credit policy. To this end, NACB "Guide to Applicant" is given to all prospective applicants. It contains the various rules and regulations. The projects, for which a loan is sought, should not be in conflict with any stated federal or state policies.

For corporate applicants, the purpose for which a loan is sought must be provided for in the objects clause of the Memorandum and Articles of Association. The banker or credit officer is not expected to lend for ultra vires activities. This remains so even though the Company and Allied Matters Decree (AMD) 1990 has reformed the ultra vires doctrine by offering protection to an innocent third party under S.39 (3). However, a party who has actual knowledge

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or ought to have known of the ultra vires act may not be able to rely on the provision of this section to enforce the ultra vires transaction S.69 (d) (i). There is also the need to check the Articles of Association to ensure that the request is within the powers of the Directors of the company.

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(2) **Financial Commitment Required**

Here, the customer at the time of filing the application form should state exactly how much he wants to borrow. The banker is not obliged to specify how much the applicant is willing to borrow. The application request should conform to the bank's guidelines and ceiling levels where applicable. But, where an applicant has not asked for enough, it is not a wrong banking practice to suggest to him that he might have estimated his borrowing requirements incorrectly. Closely allied to this, is the issue of the applicant's stake in the business. This must be sufficient. This is because a greater financial commitment induces greater personal commitment. To re-emphasize this NACB Ltd vides a circular reference GM0/43/v5/332 dated 22nd July 1996 provides that "henceforth, applicant's contribution to projects should be tangible, easily verifiable and be in place before NACB contributions are made".

(3) **Loan Security**

This is one of the vital and most important aspects in credit disbursement. This issue is considered at the identification stage. The question to be asked here is what are the bank's required securities in case of default. Such security requirements are for all the various schemes NACB Ltd runs i.e. the small and larger scale loans. For example, a common security we are all familiar with is the Landed property. It is important that the ownership of such property is clearly identified through the appropriate and duly registered documents of title. Ownership of security and its status should be established by reference to authorities with power over documents to the land, such as the state lands registry, the corporate affairs commission, other banks, etc. This is one of the aspects or trademark of NACB Ltd, if loan is sought. However, when all the reports are received, they should be carefully examined for defects.

(4) **Loan Repayment**

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In determining loan repayment capacity, NACB Ltd always requests its clients to submit a feasibility study report on their proposal. From the document one can have a quick and on the spot assessment of the proposal for which the

loan is being sought. It is very important to assess the likely ability of the applicant to repay the loan. Where an applicant proposes adequate security, it would be inappropriate to advise – if in your opinion, you will probably need to revert to the security offered. Hence, NACB Agricultural Project and Management Committee (APMC) paper has a provision, which states, "The project is recommended or not recommended for financing because it has been found to be feasible and viable or not feasible and viable."

Further more, the experience of its staff especially those on the field can also be a good guide in determining loan repayment. For in the late 1980s and 1990s, it was known that large-scale poultry projects were not viable, hence the bank generally turned down loan requests on such projects, during the period.

Another issue under loan repayment consideration is the applicant's willingness to repay. Here assessment of the applicant's character is very important and vital. For as a banker, one must believe that not all applicants are saints, for there is no act to show the mind's construction in the face. However, one must be reasonably satisfied that the applicant will be trustworthy enough in his or her dealings

with the bank. As part of NACB's lending policy, enquiry is raised on the applicant (where it is a corporate body) to his bankers and other banks to investigate the credit worthiness of the applicant. This is called status enquiry exercise. In addition, through personal interviews, one can determine the character of the applicant.

3.2 CREDIT DISBURSEMENT CRITERIA

Before any disbursement to credit offer is made a disbursement clearance exercise is carried out through the following:

(a) Check list of requirements are available at the head office of the bank, and all its branches nationwide, for both individuals and corporate clients and for various categories of loans (see copies for all types of loans in the appendix).

Having done a good evaluation at the identification stage, the next step is to appraise, Implement, supervise, disburse, monitor, and evaluate the project to ensure good credit management and effective financing.

3.2.1 **Project Appraisal**

Project appraisal is an assembly of qualitative and quantitative information obtained at the identification stage, on the project. In project appraisal, nothing should be taken for granted, for project appraisal involves an examination not only of the intrinsic soundness of the project itself but also of the circumstances surrounding it because virtually all the economic theories form part of it. Appraisal exercise therefore examines project from seven (7) different aspects of economy, technical, managerial, organization, commercial, finance and security.

However, in order to ensure good credit disbursement and management, an appraisal committee has been set up in NACB Ltd known as the Agricultural projects Management Committee, which at the end of every meeting passes a standard paper report. Such a committee paper examines the following:

- It offers a set of terms and conditions on which the proposal should be implemented;
- It offers schedule and procedures for project implementation;
- It offers information on the viability and profitability of the proposal;
- It offers a guide to management decision; and

- It offers an organized set of information on the nitty–gritty of the project.

The Agricultural Project and Management Committee (APMC) papers are made available to all the committee members, who later examine the facts set out on the paper and decide whether the bank's fund should be committed to the execution of the project. Such decision as to commit fund to the execution of a project is informed by the entire information provided in the appraisal reports, but more importantly on the viability and profitability indicators. In NACB Ltd, the viability and profitability indicators used are:

1. **Net Present Value (NPV)** otherwise know as net worth is defined as the difference between the discounted stream of cost and discounted stream of benefits. For a project to be acceptable, it must have a positive value that is greater than zero.
2. **Cost Benefit Ratio**: is defined as the sum of discounted stream of benefits divided by the sum of discount stream of costs. This must have a Value that is at least greater than zero.

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3. **Internal Rate Of Return (IRR)**: Is defined as that discount rate at which the discounted stream of benefit equals the discounted stream of cost.

IRR- is computed based on the below formula, which is:

$$IRR = DF + (DF_2 - DF_1) = \frac{NPV \times DF_1}{Absolute\ Value\ of\ NPV\ and\ DF_2}$$

Where

DF_1 = Lower Discount Factor

DF_2 = Higher Discount Factor

NPV = Net Present Value

The decision criterion here is that the IRR must be equal to or greater than the lending rate or market rate of interest.

In addition, emphases are placed on security provided, which influences the APMC's decisions to approve or reject a project. Once a project has been approved, the next stage is implementation.

3.2.2 Project Implementation

This commences with the receipt of legal clearance by the implementation unit, from the legal directorate. However, implementation is the process of disbursing an approved loan to a client to carry out activities, which the bank agreed to finance in order to realize the purpose and objectives of the project.

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After a loan has been approved, an implementation plan is agreed with the client. He/she endorses it and a copy is given to him. An implementation plan provides a guide for the execution of a project and it is subject to changes from time to time, as there are new developments in prices or conditions different from those at the time project was appraised

Before a project is implemented, however, the loan must undergo a legal documentation process after which a legal clearance is issued by the legal department to the project implementation unit for implementation of the project.

3.2.2.1 **Legal Documentation**

Having given the approval by the APMC, the approval is communicated to the applicant by the bank's legal officer. The approval letter usually indicates the period over which the approval will be effectual. This is usually 90 days. Within this period, the applicant is expected to communicate to the bank his acceptance of the approval. The acceptance of the approval creates a binding contractual obligation between the applicant and the bank.

Having accepted the approval, the next stage in the lending procedure is the documentation stage. This stage is primarily concerned with securing the interest of the bank by ensuring

that the customer executes the loan agreement where the security offered are genuine and registered and also to ensure that the appropriate authority duly acknowledges the charge created by the bank.

However, under legal mortgage, the bank prefers security, such as landed property. Outside this, other forms of securities acceptable to the bank are Insurance Policies, Fixed Deposit Certificates, Share Certificates, guarantee from reputable Banks and Government. Having satisfied all these, project proceeds to the disbursement stage.

3.2.2.2 **Loan Disbursement**

Here the approved loans are disbursed out in sequential stages and disbursements are made for subsequent stages only, where there are evidences that the preceding stages have been or are likely to be successfully completed. A pre-disbursement visit usually precedes any disbursement. It is important and essential that the applicant be fully involved in the discussion held during the visit. This is very vital because all parties to the project, as approved by the bank as well as the implementation period, must understand the concept of the project. Details of the information to look out for during pre-disbursement (take-

off) visits are fully set out in section C. 6 of the bank operation manual.

During the visit, attention is paid to all aspects of the project and even documents necessary for the raising of disbursement is obtained. Every factor that may infringe on the success of the project either positively or otherwise, no matter how insignificant they may appear, is reported.

Agreement is reached with clients on all the stages of project implementation. When there is disagreement that the visiting officials are not able to sort out with the client, it is commented upon for management consideration. The report is as detailed as possible and every evidence and fact necessary for the implementation of the project is contained therein.

3.2.2.3 **Project supervision**

As one of the policies of NACB Ltd toward good credit management, a supervised credit system must ensure that project supervision is effectively and efficiently carried out on the funds disbursed and is used to execute the project at the least possible cost with prompt completion and that the completed facilities are efficiently operated and maintained. Supervising a successor to appraisal exercise is geared towards achieving the set down targets. During supervision visits,

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reports written provide detailed information on the progress or otherwise of the project. Such a report is concluded with definite recommendations on the project and what needs to be done in order to keep the project on course. Where a project is derailing, specific recommendations are made on actions that need to be taken in the opinion of the supervising officer in order to bring it back on course. The supervision report may at times recommend that a project (even when still under implementation should be discontinued as fast as possible). One important point to be noted is that project supervision does not consist merely in finding faults but in ensuring that project objectives are attained at the least cost and in the best time.

3.2.3 **Project Monitoring**

Monitoring is gathering of information and reporting, which provide project monitors and managers with the necessary knowledge of project progress to make improved implementation decision. However, the major objectives in monitoring projects are:

1. To ensure that assisted projects are implemented and operated satisfactorily.

2. To identify critical areas in the functioning of the project and diagnose symptoms of any incipient weakness.
3. To nurture projects promoted by first generations entrepreneurs during the critical period of adjustment and survival.
4. To promote feed back which would be useful for processing new applications for financial assistance, and
5. To nurse and rehabilitate ailing projects with a reasonable chance of revival through financial and management support.

Project monitoring is expected to commence immediately the first disbursement is made up to the time the loan is fully liquidated. In order to achieve these objectives, we may need to examine briefly some of the monitoring activities that can be used, which are: -

(a) **Periodic Reports:** The periodicity varies between quarterly and half yearly; while other reports are written as the need arises. Case officers undertake a periodic visit to write "situation reports." The object of this report is

to monitor the progress of the project, assess performance and understand the nature of the problems faced by them. Discrepancies between objectives and actual performance in volume and value are analyzed and the problem that come to light therefrom, provide a useful basis for a dialogue between the bank and the client. The books of account of the client are interpreted and analyzed. Also, periodic report should include other items as:

1. Adequacy of management set-up in coping with the task of running the project.
2. Performance of the project in terms of daily production, utilization of installed capacity, availability of essential inputs, utilities and adequacy of technical staff.
3. State of employer- employee relationship.
4. Debt servicing performance records.
5. Marketing strategies.

(b) **Debt collection**: Debt collection is an important monitoring activity. Debt collection is a special act and every monitoring staff must be fully equipped to cope with the challenges of debt collection. Demand notes must be promptly delivered followed by actual collection of funds. Case officers are expected to prepare periodic Debt Collection Reports.

3.3 PERFORMANCE EVALUATION

Performance evaluation entails comparison of achievements with set targets, which were agreed with the clients. Hence it is necessary to set targets commensurate with project size, to measure and quantify set targets such as 50 hectares will be cultivated for maize, 30 bags of fertilizer will be bought, 5 tons of maize will be realized per hectare, etc. In the process, where a target has been achieved, it should be properly indicated in the report. However, where there is adverse achievement, explanations should be sought. The client's responses should be clearly documented and presented to management as a guide to further necessary action.

The evaluation exercise should pay particular attention to the recovery of the loan. Reasons for deviation from the agreed

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amortization schedule should be sought. The result of the evaluation exercise, especially in terms of debt service, is the classification of clients (in relation to their loan repayment performance) into the following categories:

1. Able and willing
2. Able and unwilling
3. Unable and unwilling

The above categories have serious implication for the future of the project. The evaluation exercise may set the stage for a probable project closure. In the event of this, the appropriate steps to follow are duly codified in NACB operational manual.

3.4 CREDIT MANAGEMENT IN EQUITY INVESTMENT IN NACB LTD

Although the bank ordinarily funds projects by granting loans, it may also engage in such funding by way of becoming part or full owner of companies, which engage in projects that are of interest to the bank. It usually acquires such ownership by purchase of shares (equity) in companies.

If the bank receives an offer of a proposal to engage in equity participation, the General Manager (investments) shall present it to the management committee upon instruction from the

Executive Director (finance). Such a paper contains the following information:

(a) The legal status of the company.

(b) The object of the company in relation to NACB Ltd equity policy.

(c) NACB Ltd equity participation and board representation.

(d) Analysis of the audited statements of account.

(e) A critical analysis of the proposed project of the company in terms of its technical, financial, managerial, commercial and economic aspects.

(f) Valuation of the company's shares.

(g) Recommendation on whether the bank should take shares or not and if so, the level of participation and the conditions for such participation.

If management endorses the proposal, it shall make a recommendation to the Board. The General Manager (investments) then arranges for the preparation of a Board paper, which, is presented to the Board by the Executive Director (finance).

Having secured for the proposal approval from the Board, the General Manager Investments shall then act as follows upon notification of the approval by the Executive Director – finance.

1. Inform the company of the Board decision. If the decision is for the bank to participate, the conditions attached to the participation shall also be conveyed to the company.
2. Ensure that any condition precedent to disbursement of funds for such equity is fulfilled before funds are released.
3. Advised General Manager – finance to pay for such equity as approved by the Board.
4. Ensure that all other conditions, which are attached to the participation, are met.
5. Ensure that the share certificates are duly issued and delivered to the Bank for safekeeping.
6. Ensure that copies of the company's Memorandum and Articles of Association, and the certificate of incorporation are delivered for custody.
7. Ensure that a register of share certificates and their nominal values are maintained.

As part of ensuring effective credit management, the bank carries out its own policies, that is of monitoring and evaluation of such equity investments, where by analysis of the companies are

carried out not less than once a year by the General Manager, who later reports to management on the state of the company.

For effective credit delivery and management, the NACB composition seems solid and well structured.

3.5 NACB ORGANISATIONAL STRUCTURE

The bank's organizational structure is not only solid but also firm. The structure comprises the three arms of the bank: the Head Office, Zonal Office and Branch Office, and is followed in any policy implementation or execution, (see Appendix).

As depicted in the organizational structure, the highest organ of the bank is the Bank Board of Directors – (the Board). It is composed of full – time (Executive) Directors and part-time (non-Executive) Directors. At the helm is the Chairman of the Board, who is one of the part-time Directors. The Board determines policy of the bank and broad guidelines for the operation of the bank.

Next on hierarchy is the chief Executive of the bank, who is the Managing Director, and who is one of the Executive Directors. Currently, there are four other Executive Directors, who are immediately under the Managing Director in the hierarchy of the bank. The bank Executive Director heads a Directorate. The office of the Managing Director is one Directorate. There are currently

four others, which are Operations Directorate, Finance Directorate, Services Directorate, and the Research and Development Directorate.

Each Directorate is made up of Departments, each of which is headed by a General Manager. The current Departments are as follows:

1. **Managing Director's Office**: Inspection Department legal Department and office of the company secretary.
2. **Operations Directorate**: all the Zonal offices.
3. **Finance Directorate**: Finance and Investments Departments.
4. **Services Directorate**: Administration and Estate Departments.
5. **Directorate for Research and Development**: Research and Development Departments.

Some Directorates have special units, which assist the Executive Directors. In the Managing Director's office, for instance, is the Corporate Affairs Unit. In the Operations Directorate are four units: Project Appraisal, Project Implementation, Smallholder and special projects and field services. In addition, some of the Executive Directors have special

Assistants in the rank of managers and Assistant General Managers.

Departments are divided into divisions, which are headed by Assistant General Managers. The Divisions are further divided into sections. The substantive heads of section are in the ranks of Managers, Deputy Managers, Senior Assistant Managers, and Assistant Managers. Officers and other ranks are also found in the Departments.

Each Directorate and Department is charged with specific functions. These functions have been drafted for each Directorate and Department in their own manuals.

The zonal offices, which are in the Operation Directorate, are headed by Zonal General Managers. Each Zonal Office supervises a group of branch offices. Each Branch office has a Branch Manager who is usually in the rank of Manager or Assistant General Manager. The bank also has Representative offices, which are manned by Assistant supervisors (credit) who report to branch managers.

For effective credit management and disbursement, a number of committees have been set up within the organizational structure of the bank with specific functions to perform. The committees are:

(a) The Executive committee;

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(b) The Management Committee;

(c) The Zonal Agricultural project and management Committee; and

(d) The Branch office Agricultural Project and Management Committee.

All the said committees must form quorum before any policy decision or verdict is reached. Although membership is fixed, co-opted members are allowed. Evidence of decisions taken must be documented, and those co-opted indicated.

CHAPTER FOUR

4.0 CREDIT MANAGEMENT AND ADMINISTRATION IN FIRST BANK OF NIGERIA PLC:

4.1 GENERAL REQUIREMENTS

The first bank of Nigeria – Plc under its credit policies and guide, has its own procedures towards lending – i.e. credit disbursement. However, we shall examine the following – credit or lending policy, credit appraisal, credit applicant evaluation, credit control and debt collection policy, Debt recovering analysis of credit appraisal and securities acceptable.

As apart of its loan procedure, all credit applicants must submit a completed hand written application letter together with a form duly prepared to the bank along with acceptable proposals. Other documents to accompany the loan proposal must include the following:

(a) **Financial records:** The client is obliged to submit three year financial statement with balance sheet to show sources and uses of funds for each operating statement and year. A comprehensive budget analysis covering the life span of the project is very vital.

(b) **Feasibility Study:** Detail proposal of operations and full description of the structure of the company (if it is

a corporate client) showing technical and non technical qualifications, partners and their shareholding, human resources capability, and also indicating management structure of the organization. Availability and suitability of a project analysis – sites, raw materials and sources of supply must be acknowledged.

(c) **Market Survey:** Market survey is essential so as to determine the economic indexes of the demand and supply, of what is to be financed – or credit to be granted for, especially with import and export of goods and their acceptability in the market.

(e) **Credit obligations:** Every bank has a target market, which comprises of firms and high network of individual clients that meet the bank's set credit criteria. These are the purposes for which credit is being sought, amount required, and the client's contribution. This should be 20% and the period such facility will cover and whether it is sufficient for repayment to be accomplished and finally, the interest rate. Details of security to be offered

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are required and some statement of the account for twelve months. All these determine how sound a loan portfolio is and gives an insight on the reason as to whether the bank or client should invest or not and the ability of the project to be sustained. These are strict procedures and general guidelines of the Central Bank of Nigeria (CBN), to ensure the purpose for which the loan (credit) is being granted is met.

4.2 PROCEDURE FOR FINANCING, ADMINISTERING AND MANAGEMENT OF CREDIT

First Bank of Nigeria Plc like all other banks has its own lending policy. A policy is a general statement or undertaking that guides or channels thinking in decision-making and this can be expressed or implied. As part of its policy, at the branch level office, First Bank Plc grants authority to its branch managers to disburse loans up to a specific amount limit and if such loan request is in excess, it is referred to a higher authority, either at the regional office or straight to the head office. Here the superior management approves or declines based upon recommendations of

the branch manager, that is, his assessment of the applicant and the documents attached.

However, the general credit guidelines and policies for all banks emanate from the Central Bank of Nigeria (CBN), but the administrative style employed in implementing these guidelines and policies are left to the discretion of the respective bank management. As earlier pointed out, First Bank allows certain discretion to be exercised by its branch managers, depending on the size of branch and status of the officer who approves such loan/credit or overdraft request based on its merit and up to a specified limit. But because of such delegation of authority to branch managers, some misuse such level of discretion. For it has been observed that managers offer loan/credit and overdraft without complying with the CBN prudential guidelines either because of personal interest or fraudulent reasons.

4.2.1 Procedure For Applicant Appraisal

Having completed the form, the evaluation of applicant for credit must be made, based on factors or criteria such as, applicant's character, collateral offered, applicant capital capacity, and the management strength – if it is a corporate client. Trust is very important in assessing applicant's character, which also determines the lender-borrower relationship, and if lacking, no matter the

potential of the profitability to be realized, offers no basis for consideration. Applicant's character can be determined also, through his statement of account, audited financial statement – if a corporate client; such credit criteria help in effective and efficient decision on credit disbursement as well as management for the benefit of the bank.

But for an individual applicant, who receives only approval for disbursement, detail analysis of the information provided in the application form must be made, and it is the responsibility of the lending officer to obtain all necessary data to support a sound credit decision. There must be full understanding of the following:

(1) Purpose of the loan/credit, which must be in accordance with government directives in word and it, must be legal.

(2) The amount required must be in proportion to the borrower's own resources and his percentage in contribution to the project to be financed. Such amount must be within the power of the borrower and must be sufficient for the purpose.

(3) Period of loan/credit repayment must be analyzed and must be short that is between 1 to 3 years, except in

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exceptional circumstances and it must be sufficient for the project.

(4) Sources of income for credit repayment must be clear and fully understood by both parties. The source must be reasonable, certain and adequate and should be comfortably effected from the proceeds of the business – i.e. deductions.

(5) The bank's independent auditor must certify financial statement or audited financial statement of the client. The auditor's opinion assists the bank in making its own decision on the client. The audited figures are then analyzed using financial ratio analysis, which is an effective criterion of knowing the credit worthiness of the client, be it corporate or individual. Also, where credit is personally guaranteed by some individuals, guarantors of such credit must have their financial statements audited, but where such audited statements are not available, it may be waived as an exception. However, for un-audited account, the officer must sign them or management staff of the borrowing company or individual, certifying the correctness of the figures and information contained therein.

(6) Statement of accounts of the client with the bank must be evaluated to assess performance of the account, in terms of turn over, revenue earning and number of days in credit.

(7) The character of the client both in his accounts performance and his business is very important of all.

4.2.2 **Securities And Effective Decision On Credit Management.**

First Bank Plc gives high priority to valued securities for any credit disbursement. A security must be fully documented and completed because a non-properly documented or faulty documentation could mean the non-existence of security. However, First Bank Plc accepts securities such as cash, that is, in terms of deposits, be it short term or long term deposits, legal mortgage over property, stocks and shares, guarantee by individual or corporate body; letter of hypothecation; Bonds and guarantee, and debentures.

Although banks agree that realization of securities should come as a last resort, and that realizing securities in itself does not go without cost, banks still take securities and study the relative advantages of each security. As such, a good security should have the following features, which are also used by First Bank Plc.

(a) Absolute title for security should be obtained with little difficulty.

(b) In term of cost, it should be realistic and with minimum delay and expenses.

(c) The value of security should be ascertained at all times and should be capable of being estimated with good degree of accuracy and

(d) It should be free from any liabilities, i.e. encumbrance.

To further strengthen its confidence on information supplied by the applicant, the financial statement of the applicant is further scrutinized, to determine whether the applicant falls above or below the minimum quality standard, using some analytical techniques, which are:

(i) **Financial Ratio**: Financial ratios make it easy to determine which one has the greatest productive power. Here the credit analyst places more emphasis on the client's liquidity and his ability to pay account on time. Also, through these empirical studies, the credit analyst considers a firm's financial strength, the character of the client and the management composition in relation to the Canon of lending.

(ii) **Numerical Scores System**: This is one of the sophisticated methods being used to screen clients, but because of their sophistication, experts are employed to perform such analysis on client for the purpose of credit.

(iii) **Statistical Tools**: For an in-depth analysis, regression analysis and discrete or discriminate analysis are used to ascertain the basis of the client's weighted average overall score provided by such techniques, in order to have a fair judgment on the applicant.

The entire above are accurately achieved using computer technology, and make it quicker to arrive at decision on client or applicants.

Credit management and administration require a good decision making process. Here a manager's decision must recognize the credit limit, which is basically an investment decision, especially on the amount the bank is willing to invest. Such credit limits are usually fed on to the computer and the applicant or customer must not exceed the credit limit in force. However, where an applicant wants credit in excess of a limit, then necessary approval must be sanctioned before any withdrawal is done.

Also, re-assessment of the customer's account with authorized limit is very vital to ascertain whether the amounts granted are utilized and if there is any problem to be re-examined, customer counseling is very vital and has considerable prospects for the future of the client's business or project and the cost and benefits already ear-marked on such project.

4.2.3 Policy On Credit Administration, Control And Monitoring

The risk assets department of the bank is solely responsible for the disbursement of loan/credit and it must ensure that all the stipulated rules and guidelines embodied in the sanction ticket are implemented and abide to. Thus, most of the sanctions are centered on securities perfections, which may not have been done before withdrawal is made, such as stamping and perfections of mortgages, charge of letters, insurance etc.

As part of FBN Plc policy, credit administration and control commence as soon as approval is issued and the credit department now becomes responsible for ensuring that the applicant or borrower complies with all terms and conditions relating to credit facilities before sanctioning disbursement. It is the duty of the credit department to liaise with the Legal Department to ascertain the expiry dates of all the loans and security documents and ensure that renewal of facilities is not omitted, if necessary. From the

branch offices, quarterly returns on loans are made to the regional office and/or the head office and this exposes the extent of loan repayment; while weekly returns on overdrafts are made to reflect how managers are approving loans and overdraft and if it is within their limit. FBN Plc policy goes further in waxing its credit management portfolio, by credit references as well as credit checks where data about the applicant or borrower are secured from other bankers already in operations. As for new borrowing, checks are made through enquiries and must conform to the Memorandum and Article of Association. These are reviewed by the credit department to ensure that the proposed extension of credit by the customers is within the borrowing capabilities of the company and its directors or the individual.

The assets management department carries out annual review or audit of credit, at least once a year, for all credit facilities and credit files. For the purpose of ensuring effective credit management and administration, this review/audit are very vital and adequate documentation and adherence to policies and procedures as set forth in the banks policy guidelines as well as the CBN policy guidelines on credit are religiously followed.

Under FBN Plc policy, credit files for the bank are prepared to contain all the necessary information for users to have a

complete understanding as well as history of the borrower/bank for good relationship to be established. Such credit files are made confidential and are kept under the custody of the credit department, which ensures proper record of their movement. Also ensuring that all legal and other documentations required for a loan facility are detailed in the conditions precedent and the collateral packages are executed and perfected where necessary and copies filed in the credit file while originals are lodged in the vault.

Evaluation and inspection of collaterals issued are carried out as part of its policies, for management of secured facilities requires regular and periodic evaluation of collateral held and verification of their adequacy of margins. This is always supplemented by physical inspection as well as verifications of the collateral on a regular basis to ensure both its existence and adequacy.

4.2.4 **Management of Bad and Doubtful Debts**

First bank of Nigeria Plc like any other financial or business organization is established to carry out business transactions with the aim of making profit. In attempt to make this profit, it must render certain services to its customers. Thus, it accepts deposits, lends out, and in between these services rendered, makes its own profit. Since certain reasonable percentage of bank's profit is from

lending transactions, one would normally think that the incidence of bad debts would naturally arise because of banks' quest for profit. However, research has revealed that while certain reckless lending was to make good deal of profit for the banks, some were made out of mere carelessness and personal interest. The following have been observed as major causes of bad and doubtful debts.

- Careless and reckless attitude of lending by officers and managers.
- Dishonesty of borrowers.
- Fraudulent act of credit officers and managers
- Business failure.
- Diversion of funds
- Overtrading.
- High interest rate
- Government Economic Policy
- Political Lending

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The issue of bad and doubtful debts is so serious that it has become a major concern in the banking industry. That was why the Federal government through the Central Bank of Nigeria (CBN) issued the prudential guidelines which required loans and overdrafts to be classified as performing and non-performing, with

the non-performing loans comprising of substandard, doubtful and less-secured debts.

When the disbursement of credit facility is made, then its sleepless night has begun, knocking hard on the doors of client for repayment of loans especially when the expiring period falls. Thus, the bank must ensure that the payment will be received as quickly as possible as at and when due. The more the delay, the greater the risk and losses to the bank, and as such, it requires an efficient and effective collection policies and procedures. At the same time, the method of collection must not be offensive, but persuasive enough to secure the bank's goodwill. Chasing bad debts can be an expensive process. The bank must ensure that the expenses incurred in collecting debts is not more than the actual debt as the aim will be defeated.

FBN Plc has standard policy and procedures, with a department set-up to perform this task. This is the Credit Recovery Department at the Head Office. Statement of accounts monthly for firms and quarterly for individuals are sent out to remind customers to pay back their debts.

As part of its policy of ensuring effective collection, once loans and overdrafts have been granted, the bank reconciles the repayment with the due date. If payments are not received, the

bank usually takes appropriate steps to avoid delay and bad debts in its coffer. The following are the tools employed by FBN Plc for effective and efficient debt collection policy:

- Telephone calls.
- Personal visit
- Letters.
- Security realizations
- Institution of legal actions, and
- Employment of debt collectors.

The above tools are employed one after the other, or two are combined at the same time. As such, recovery is a follow up process not a procedure. Therefore First Bank of Nigeria Plc minimizes its exposure to difficult loans and charge offs. The credit department notifies the bank of any significant information relating to credits. Anytime there is a significant change in the financial or business condition of the client or if a client is not meeting his business plans, all credit facilities for that client must be reviewed promptly to determine the required action. Potential problems are identified appropriately, risk rated and placed on the watch list in sufficient time to avoid any bad and doubtful debts and for it to preserve its goodwill.

4.2.5 FBN Plc Status on Credit Administration

Banks usually under provide in order to show their shareholders that they are doing fine, but a closer examination reveals that the banking industry is not performing so well as every one tends to believe.

Things changed in 1989, when the effects of reforms of the financial system by the regulatory authorities, began to manifest their impact on the economy. Interest rates were volatile and high, and credit risk was getting higher and in many cases, the returns on credit, were not commensurate with the embodied risks. To address the issue of risk, FBN Plc instituted additional measures by forgetting its blue chip customers, introducing new products to improve its earnings, and loans recovery drive was intensified. In spite of all these internal measures, the operating results were adversely affected in 1990 and 1991 and the bank became one of the first victims of the credit guidelines. Thus, despite that the banks gross earnings for December 31st, 1990 stood at ₦1,433 million, instead of the usual profit, a loss of ₦205 million was recorded. For many, the bank was carrying a portfolio of non-performing loans and advances dating back to 1970's and 80's and when cost became generally high, borrowers consequently confronted high interest rates and high cost of servicing loans and

advances. Ironically, what happened in 1990, Jolted the bank into action and the Elephant woke up from its slumber, following the shock of 1990 and hence effective risk management was implemented. The event also created the need for more vigorous approach in evaluating applications for loans and advances; it diversified its loan Portfolio by carrying the blue chips more than before. First bank of Nigeria Plc has survived and is now the leading bank in the Nigerian banking industry and it has been engineered to become the first.

4.2.6 **Organizational Structure of FBN Plc**

At the peak is the chairman, assisted by other directors, that is the executive and non executive. At this level, all policies of the bank are broadly spelt out and determined as guidelines for the operations of the bank.

The full-time directors of the bank assist the Managing Director, who also doubles as the Chief Executive. The directors are in turn supported by the General Managers at the Head office and Deputy General Managers at the regional and branch offices level for the successful implementation of the bank's policies.

The flow of authority and responsibilities moves from the Head office to the regional office and to the branch offices with over 200 branches nation wide and staff strength of over 2,000.

The bank has firm policies that must be complied with for effective and efficient flow of credit management.

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CHAPTER FIVE

5.0 ANALYSIS OF RESULTS

5.1 INTRODUCTION

In 1.3 of chapter one of this study, three objectives were set as follows:

(i) To critically evaluate the conditions under which credits are granted to applicants in the First Bank of Nigeria Plc and the Nigerian Agricultural and Cooperative Bank Limited;

(ii) To examine the techniques of credit monitoring and supervision from the stage of disbursement to the stage of debt recovery.

(iii) To find out whether the techniques of loan administration enforced in the two institutions under study conform to the canons of lending.

Consequently, in chapters three and four, conditions under which credits are granted to applicants and the techniques of credit administration and monitoring in the two institutions were discussed, respectively.

5.2 THE CANONS OF LENDING

For the banker, project financing, be it for the individual or corporate client, the viability and the profitability of a project for

which the client seeks financial assistance provide the necessary, though not the sufficient conditions for providing such financial assistance. Project or loan appraisal therefore starts with the assessment of the financial or credit worthiness of the client. In doing this, the banker relies on the conduct of the personal or corporate accounts of the clients.

Decision indices are derived by raising status enquiries to the applicant's other bankers (if any), and in the financial ratio analysis of past and current books of accounts of corporate clients. It is therefore a common practice that bankers demand the submission of Annual Report and Statement of Accounts for the immediate past 3-5 years for corporate clients requesting financial assistance as prerequisites for processing of application. Bankers also use the credit scoring scheme in scoring the past credit performance of their clients.

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Financial ratios are classified into three broad categories (Udo 1996). The ratios help to measure the liquidity and debt safety of an enterprise, the operating efficiency and the profitability of an enterprise. The benefit of these ratios in project or loan appraisal is that they can be applied on projections as well as on previous records of operations or Audited Statement of

Accounts, to predict the character (credit worthiness), capacity and capital position of corporate applicants.

Levie (1996) gives two common bankers' checklist in assessing or appraising loan or project proposals. This checklist constitutes the canons or principles of lending. The first consists of the 5Cs which decomposes into the "Character of the borrowers," "Capability to repay," Conditions" (i.e. type of product, the industry and the economy), "Capital provided" (i.e. the debt-equity ratio), and "Collateral" (security).

The second checklist given by Levie is called the CAMPARI. This decomposes into "Character," "Ability to borrow and repay," "Margin to profit," "Purpose of the loan," "Amount of the loan," "Repayment terms," and "Insurance against non-payment" or security. He adds that some banks have introduced more complete checklists that are closer to credit scoring systems. Those banks assess the management, market strategy and the general competitive environment, by using a statistically determined weighted scoring system, and according to Levie, opinions vary as to the value of these for new ventures, i.e. new projects. However, many other bankers place more weight on their judgment of how the entrepreneur will cope in any eventuality than on their assessment of the project strategy.

Bankers may suggest changes in the entrepreneur's proposal in order to reduce the bank's exposure to "acceptable" levels. In terms of debt/equity ratio, "acceptable" according to Levie, usually means roughly equal contributions to the capital base of the business by the promoters and the bank. In fact, the First Bank in its credit guide to applicants' states as one of its conditions for granting of loans that the applicant must show some involvement in the project, which will serve as his/her equity contribution. The level of contribution is a pointer to the seriousness and commitment of the applicant to the realization of the project and for the bank, a pointer to the debt recovery potential of the loan.

Therefore, bankers need to see that the entrepreneur is highly committed financially to the project by putting as much as necessary. They also need to be sure that the finance is actually needed in the amount and type requested.

Levie also said that security is probably the most contentious issue in the entrepreneur/bank relationship. He says further that bankers need at least one and preferably two alternative sources of repaying the loan other than cash flow. They need land, buildings, vehicles, government stocks, quoted shares, insurance policies, etc, although they have security potentials only at their distress (mortgage) sale value. He observes further that often, the only

fallback security available at start-up is a personal guarantee backed by assets, usually the family home. But that entrepreneur hates these because they wipe out the advantage of limited liability. But the bankers like them because they feel it will make the entrepreneur to work much harder to ensure the loan is repaid.

In all, the banker, as a financial expert has to assess the technical feasibility and the economic and financial viability of a project before advancing credit to the entrepreneur. This involves considering all the aspects of the project including the managerial aspect. For according to Kayode (1977), "if a company has nothing going for it except good management, it will make the grade, but if it has everything going for it, except good management, it will flop." The banker equally has to appraise the credit facility to reduce his organization's risk to the barest minimum.

In order to comply with the principles and canons of lending, the NACB procedures for financing and administering of credit in chapter three take into consideration project identification, project or loan appraisal, project implementation and project monitoring and evaluation. All these processes take into consideration, Levie's banker's checklist for granting of loan facilities. Likewise in the First Bank Plc. In appraising a project or loan proposal for financial assistance, the NACB makes use of

standard viability and profitability indices such as the net present value (NPV), the cost-benefit ratio (CBR) and the internal rate of return (IRR) as its decision guide in granting of loans.

The decision rule for granting of credit under the net present value criterion is that a project should be accepted for financing if the net present value is greater than zero. Under the benefit-cost ratio criterion, a project is granted financial assistance if the value of benefit-cost ratio is greater than one (BCR>1) while under the internal rate of return criterion, a project is granted financial assistance if the internal rate of return is greater than the rate of interest that the bank charges the entrepreneur. This is the lending rate or the market rate of interest.

Project identification in the NACB and indeed in all banks or lending institutions for that matter involves consideration and assessment of all information provided in the application forms, be it for corporate or individual applicants. The forms are designed to bring out some very vital information and data required for a desk appraisal of the loan proposal. Such information include, the location of the project, the total cost of the project, the amount required as loan (debt-equity ratio), other bankers of the applicant (for status enquiry on credit standing), and the names of directors, their shareholdings (stakes in the company) and their personal

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bankers (to assess their character). At times, it becomes necessary to investigate in confidence, the personal character of directors through their neighbours.

The NACB requires firms seeking its financial assistance to submit their Annual Report and Statement of Accounts for a minimum of past three years to enable the bank undertake financial ratio analysis to determine how well the firm's businesses have been performing, their ability or capacity to pay debt, and their existing financial commitment to other banks, including how well they have been servicing existing debts (if any). All these help to determine the credit worthiness of the firms.

Of course, the NACB operates a supervised credit system. This means that the project for which the credit facility has been granted is kept under periodic monitoring as soon as the loan has been disbursed up to the end of debt repayment. Project monitoring also enables the bank to keep track of the progress made by the loan and the management of such projects. At times, situations may require that the loan be recalled (i.e. project is foreclosed) before the end of loan or project life. This is to avoid a situation that the loan may fall into bad debt.

The issue of security is adequately addressed in NACB's loan operations. Loan documentation in the bank includes not just

the legal stamping of the loan agreements, but the documentation of the security document after a legal search on the security properties has been conducted. Legal search ensures that the properties are not already encumbered by another lender. The bank settles the adequacy of security for a loan facility internally. All properties proposed as securities are valued by the Estate Department of the bank. Two values are usually given – the open market value and the mortgage value. The open market value represents the value of the property if it were sold under normal circumstances. On the other hand, the mortgage value represents the value of the security, if they were to be sold under duress. It is this later value that is relevant in the credit-risk and asset management of the bank's credits. The security properties are carefully identified and located by the bank credit officers because they serve as fallbacks when alternative means of debt recovery fail or are inadequate.

All these have more or less satisfied Levie's 5Cs and CAMPARI of banker's checklist criteria for lending and by extension, credit administration.

Analysis of First Bank's credit administration and monitoring procedures has revealed results similar to that of the Nigerian Agricultural and Cooperative Bank Ltd. There is

however, one significant difference. That is that the period of loan/credit repayment must be of short duration of 1-3 years for First Bank. For the agricultural bank, credit periods are designed to accommodate agricultural production with gestation periods as long as fifteen years, e.g. for plantation agriculture.

The difference between the two banks in credit period is not far fetched. In the first place, First Bank is a commercial bank while the agricultural bank is a development bank. The commercial bank sources its loan funds from short-term customer deposits, which must not be loaned for or invested in long-gestation projects. In contracts to this, the Nigerian Agricultural and Cooperative Bank is a government owned development bank whose main source of fund is the government and long-term foreign loans guaranteed by the federal government, or from the Central Bank of Nigeria. At a point, it was mandatory for commercial banks to remit to the agricultural bank, shortfalls from their default in their agricultural loan portfolio under the sectoral credit policy of the federal government before the policy was abolished in 1997. Under the policy, all commercial banks were required to devote a fixed proportion (15%) of their total credit annually to agricultural financing. If for instance, a bank could only meet 10%, the shortfall of 5% would be transferred to the

agricultural bank. All these sources of funds are long-term which makes it possible for the proceeds to be advanced for the promotion of long-term projects.

Short of the differential in credit period, the loan administration procedures of the two banks under study are similar and conform to the canons of lending.

CHAPTER SIX

6.0 SUMMARY AND CONCLUSION

6.1 SUMMARY

We have established that lending constitutes an important function of both development and commercial banks and therefore its management or administration should be given adequate attention. The management of any loan/credit begins at the appraisal stage, which reveals whether or not the proposal is worth it, considering the source of repayment, the adequacy of such source and the key credit issues.

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Thus, partisan politics, nepotism carelessness, government policies and acts of GOD, are the common causes given for granting bad loans, for which repayment expected plus interest go BAD (Banking Digest vol.5/1991). Most banks that are now in such situation through mismanagement of their loan portfolio, considering the ratio of default in banks with government equity and those that are 100% private ownership may tend to agree that partisan politics in its rotten form has some influence in granting and administering loans. Some people believe that tribal and religious sentiments are eating deep into lending and granting of facilities and credit administration in both the development and commercial banks. Other analysts believe that loans go bad due to

human error or unforeseen circumstances, while others argue that inconsistent economic policies of the government make feasibility study to become obsolete. This often creates a situation where the expected returns do not tally with the intension of the borrowers making all assumptions unrealistic.

A good percentage of bad debts are also believed to have fallen within loans granted to government contractors, who have failed to collect fund from government due to political changes, resulting from political and economic instability. Another reason given has been the present economic down turn in the country, most businesses, corporate and individual could no longer cope with the repayment program because of the adverse effects of the structural adjustment programmes. The increased rate of inflation coupled with the increased rates of interest has contributed to credit defaults. However, in spite of the above factors, some banks have reckless lending policies, which do not ensure that loans are property secured.

Lack of proper documentation and execution of security by some banks to ensure recovery have made them loose substantial loan grants. Also, some banks' credit managers deliberately work against the credit guidelines of the bank, while others blame it all on customers who are not honest enough to make good their

obligations or as the case may be bankers still have to do much effective credit administration if their current level of bad debts is to be reduced.

Credit administration is predicated on subjective and historical information and some time future projections. However, these sources of information are not absolutely reliable, hence the need for frequent review of these sources, and strict adherence to general external and internal lending policies. This will afford the banker the opportunity of knowing which technique or sources of information that are faulty and identify any deteriorating trend or warning signals before the abrupt collapse of the business.

Thus, effective and efficient credit management and administration is a vital factor in reducing cost of extending credit and achieving the profit objectives of the banking industry. It is important to note that any negligence or dereliction in execution of the administrative machinery would be detrimental to the image of any bank, be it development or commercial bank, especially giants like Nigerian Agricultural and Co-operative Bank Limited (NACB) and First bank of Nigeria – Plc. Our analysis has shown that both banks' policies conform to the principles or canons of lending.

6.2 RECOMMENDATION

It has been established that in giving out facilities (credit) by credit managers or officers, an error of judgment can occur. Whether the error is intentional or inadvertent means a loss of the principal assets, loss of interest receivables on such assets and of course reduction, or loss of profits. This is what happened to First Bank of Nigeria Plc in the 1990s. This subsequently reduces bank market rating and public perception of bank's management ability to make sound credit judgment.

Regardless of these implications, banks in Nigeria especially the big ones are still swimming in enormous amount of bad debts. However, this trend not withstanding, if results of the studies conducted on the two banks are carefully digested and patiently implemented effectively and efficiently, they will help, not only in reducing the incidence of bad and doubtful debts, but also in recovering those debts that have become irrecoverable over the years. Also, from available data, a proven fact is that bad and doubtful debts are threatening the existence of banks, because they have affected their earnings greatly. However with proper monitoring, sound recovery policies and sound credit policies as laid down in their guidelines, effective training of staff and

retaining of skilled and qualified staff, it will all go a long way in tackling, reducing or killing the menace called Bad Debts.

6.3 CONCLUSION

Credit management, otherwise referred to as credit lending and administration is the core of bank operations. It is the central bolt or bone of the organization, and can safely be proffered as the sadness and joy of the organization, based on the use to which it is put. Most banks experience crisis because of poor management of their loan portfolio, especially in the era of competition. As such, its importance cannot be over-emphased because an organization cannot survive the odds of liquidity imbalance with an improper and ineffective management of assets and liabilities.

The time value of money or funds is given much consideration, since current spate of mounting bad debts in the banking industry is weighing down many banks. The prudential guidelines issued by Central Bank of Nigeria, yearly create a general awareness on the need for effective and efficient credit management policy within the banking industry. In placing its fund in any bank, in addition to abiding with the Central Bank of Nigeria guidelines, one must also confine oneself to loans and securities of the highest quality. The managers must meticulously

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evaluate loan applicants to ensure that only those who pass the screening test are granted credit facility. For any bank to make profit and cover cost, it must lend its fund at an interest and as such the decision as to who to extend credit facility to and who not to, is very important to a banker, because it is not always possible for the bank to select prompt payment from defaulting customers without necessarily loosing its good will.

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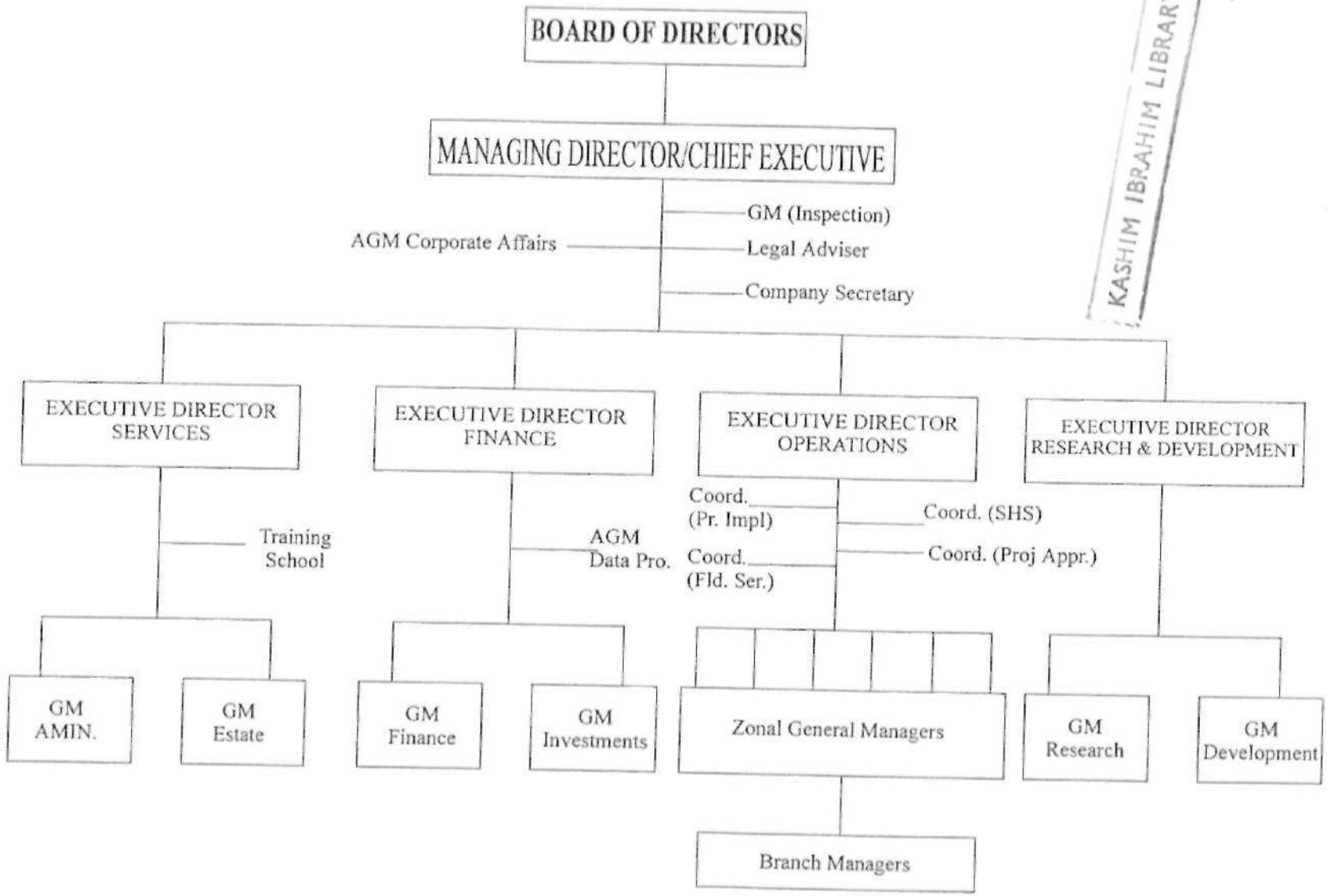
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APPENDIX I

NIGERIAN AGRICULTURAL AND CO-OPERATIVE BANK LIMITED (NACB LTD)
ORGANIZATIONAL STRUCTURE

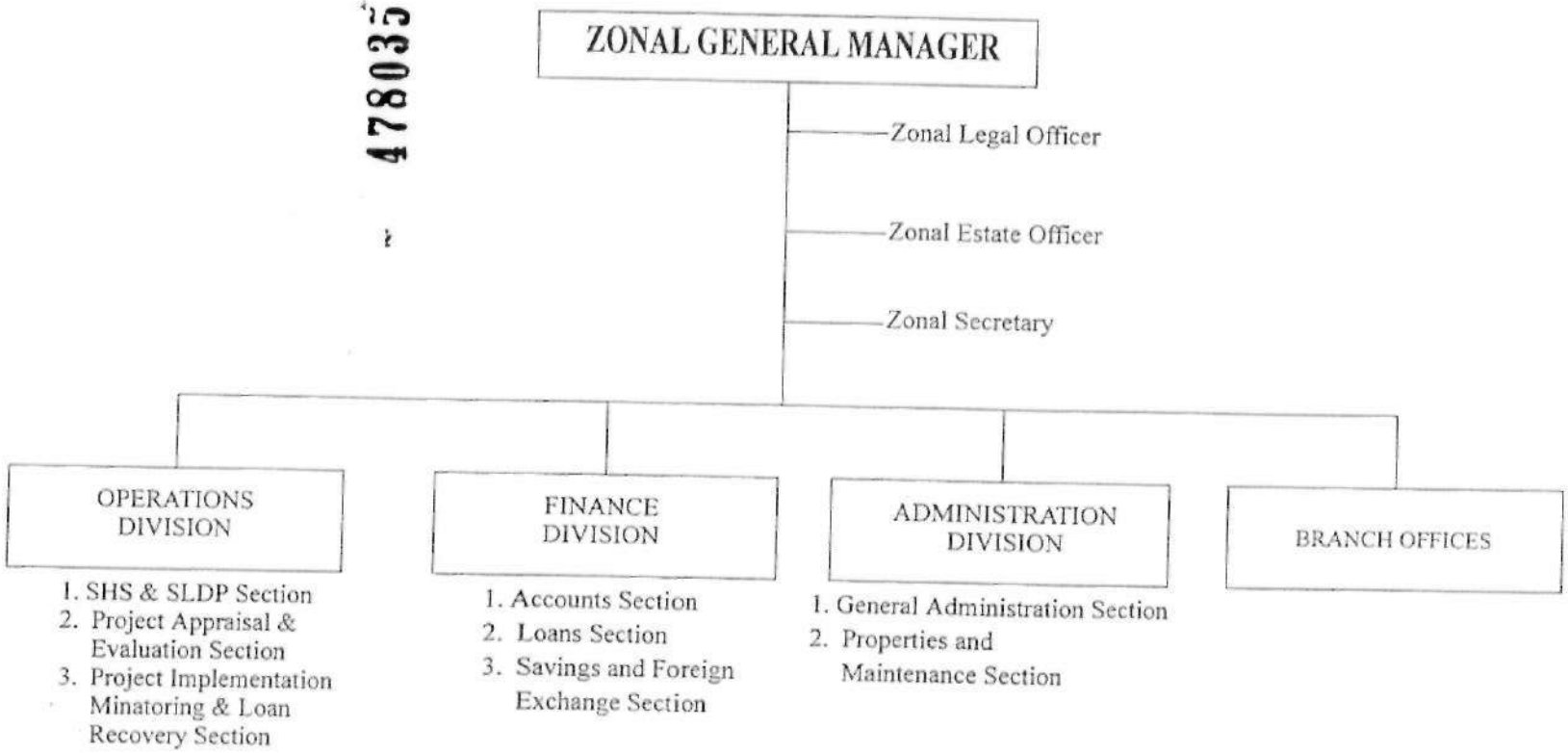
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APPENDIX II

ZONAL OFFICE
ORGANIZATIONAL STRUCTURE

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BRANCH OFFICE
ORGANIZATIONAL STRUCTURE

